BUMIPUTRA MERCHANT BANKERS BHD.

v.

MENG KUANG PROPERTIES BHD.

HIGH COURT MALAYA, KUALA LUMPUR
NH CHAN J
[ORIGINATING SUMMONS NO. S5-31-2764-87, S5-31-2604-87; S5-31-40-88, S5-31-3471-87]
12 JUNE 1990

BANKING: *Charging of interest by banks - Capitalised or compounded - Usage and practice - Not expressly provided - Ad valorem stamp duty - Whether payable on compound interest - Stamp Duty Ordinance 1949, ss. 14, 28(2).*

REVENUE LAW: *Stamp Duty - Ad valorem - Whether payable on compound interest charged by banks - Stamp Duty Ordinance 1949, ss. 14, 28(2).*

This judgment discusses the issue of whether *ad valorem* stamp duty is payable on loans of money by banks where compound interest is charged. The judgment traces the historical origin and development of usury laws, the manner in which the banks have circumvented the original usury laws, the position today and the differences in capitalising or compounding interest.

Held:

[1] There is more than one way for bankers to get what they want upon usury - by capitalising the interest or by compounding it.

[2] Through usage, banks were entitled to capitalise interest by accumulating interest with the principal and making it a debt in the amount as a principal sum itself bearing interest.

[3] If interest is capitalised in this way such loans will attract *ad valorem* duty under s. 28(2) of the Stamp Ordinance if by so doing it exceeds the amount for which the stamp on the security covers.

[4] The Court adjourned these cases *sine die* until the security which the chargee plaintiff is relying on has been upstamped with the correct amount of *ad valorem* duty.

[5] (a) Bankers throughout the countries of the Commonwealth have stubbornly continued to cling to the practice of bankers to capitalise interest when they could so easily have included in their contracts a provision for compound interest;

(b) bankers should make express provision for compound interest in their contracts; in the absence of such express provisions for compound interest, the practice of bankers inevitably must prevail and it is this practice that is their undoing;

(c) capitalisation of interest does not mean that interest has in fact been paid. It means that interest has in fact not been paid. It is because that the interest was not paid that it is to be capitalised (as this is the practice of bankers) in the sense that the interest is converted into capital.

[Cases adjourned sine die.]

Cases referred to:

Bank of New South Wales v. Brown [1982-1983] 151 CLR 514
Ex p Bevan [1803] 9 Ves 223, 32 ER 588
Inland Revenue Commissioners v. Lawrence Graham & Co. [1937] 2 KB 179

IRC v. Oswald [1945] AC 360
National Bank of Greece v. Pinios Shipping Co. [1989] 1 All ER 213 [1989] 3 WLR 1330
Paton v. IRC [1938] 1 All ER 786 at 795, [1938] AC 341
Reddie v. Williamson [1863] 1 Macph 228
Revenue Commissioners v. Lawrence Graham & Co. [1937] 2 KB 179
Re Morris [1922] 1 Ch 126
Re Waterhouse's v. Policy [1937] 2 All ER 91

Legislation referred to:
Bankruptcy Act 1966 [AUST], s. 112
Income Tax Act 1918 [UK], s. 36(1)
Stamp Ordinance 1949, ss. 28, (1), (2)
Stamp Act 1891 [UK], ss. 88(1), (2)

Other sources referred to:
Dictionary of Banking and Finance, Derrick Hanson, pp. 364-365
Legal Decisions Affecting Bankers Vol. V, 1937 - 1946, at 29, 30

Originating Summons S5-31-2764-87
For the plaintiff - DP Naban; M/s. Skrine & Co.
For the defendant - Yeap Eng Kheng; M/s. Yeap & Kheng & Co.

Originating Summons S5-31-2604-87
For the plaintiff - Shamsul Bahrain; M/s. Skrine & Co.
For the defendant - KP Chew; M/s. Yusuf Abdullah & Co.

Originating Summons S5-31-40-88
For the plaintiff - WM Chang; M/s. Mah Kok & Din
For the defendant - unrepresented and did not appear

Originating Summons S5-31-3471-87
For the plaintiff - JC Leong; M/s. Shook Lin & Bok
For the defendant - T. Gunaseelan; M/s. MS Veloo & Co.
For the amicus curiae - MS Murthi; M/s. MS Murthi & Partners

[**Editors Note:** The following cases were heard together at this High Court sitting:
List of cases:
United Malayan Banking Corp. Bhd. v. Pekeliling Triangle Sdn. Bhd. (originating summons no. S5-31-2604-87) *Perwira Habib Bank Malaysia Berhad v. Chim Wai Kuan* (originating summons no. S5-31-40-88) *Overseas-Chinese Banking Corpn. Bhd. v. Idris bin Haji Mohamed* (originating summons no. S5-31-3471-87)]

JUDGMENT

NH Chan J:

In order to understand and to appreciate the basis for the foundation of the concept for the law as applicable today, it is necessary, as with so much else in the law, to look for its historical explanation. At first the charging of interest for the lending of money was forbidden, on pain of death to Englishmen under the usury laws throughout the Middle Ages in England. And then an Act of Henry VIII in 1545 (37 Hen 8 c 9 (1545)) partly abolished the usury laws by permitting the taking of interest but it had fixed the maximum rate of interest at 10% per annum. This rate had been reduced in successful reigns until by an Act of Anne (12 Anne Stat. 2 c 16 (1713)) the rate was reduced to 5% per annum as the maximum lawful rate of interest. I quote the following passage from Derrick Hanson: *Dictionary of Banking and Finance,* 364-365:

> Throughout the Middle Ages in England, the lending of money at interest was considered to be unchristian and was forbidden to Englishmen, some of whom were hanged for the offence. The taking of interest was stigmatized with the name of usury and appears to have been based on a rather strict interpretation of the Mosaic Law: 'Thou shalt not lend upon usury to thy brother'. The Jews, however, took a more relaxed view of their law, in that 'unto a stranger thou mayest lend upon usury'.
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> Thus, the lending of money was monopolised by the Jews in England until their expulsion by Edward I in 1290. The Lombards then became the principal money lenders in England, operating from a site granted to them by Edward II in what is now Lombard Street. Despite the odium attaching to the business of money lending and its illegality, the practice continued to thrive, largely because successive monarchs were among the principal customers of first the Jews and then the Lombards. The usury laws were partly abolished by Henry VIII in 1545 and the taking of interest on loans was made legal. The rate was fixed at 10% per annum, to be reduced over the next 150 years or so to 8%, then 6% and then 5%.

And this is how it was put by Lloyd LJ in *National Bank of Greece v. Pinios Shipping Co.* [1989] 1 All ER 213, 225:

> A convenient point to start is the beginning of the nineteenth century when the Usury Acts were still in force. An Act of Henry VIII had fixed the maximum rate of interest which could lawfully be charged on money lent at 10% pa (37 Hen 8 C 9 (1545)). The rate of interest was gradually reduced in successive reigns because, as is stated in the preamble to a 1713 Act (12 Anne Stat 2 c 16 (1713)), 'the reducing of interest to ten, and from thence to eight, and thence to six in the hundred, hath, from time to time, by experience been found very beneficial to the advancement of trade.' By the beginning of the nineteenth century the maximum lawful rate of interest stood at 5% pa. Any contract reserving a higher rate of interest was 'utterly void'. If therefore a contract between banker and customer provided for compound interest at 5% pa with half-yearly rests, the contract was void; for the true rate of interest would be more than 5%.

And by Lord Goff of Chieveley in the same case when it went to the House of Lords ([1989] 3 WLR 1330, 1331):

> The earliest authorities on the subject of a bank's entitlement to charge compound interest date from the days when the usury laws were still in force, under which contracts for the lending of money with interest were lawful only if a maximum rate of interest was not exceeded, that rate being fixed in 1714 (12 Anne Stat 2 c 16) at 5 per cent per annum. It was accepted that any prior agreement charging compound interest, leading to interest being charged in excess of 5 per cent, was contrary to the usury laws.

Thus the usury laws, from the time of Henry VIII in 1545 until they were abolished in 1854 (Usury Laws Repeal Act 1854), allowed for simple interest to be charged by the lender of money, but not for compound interest as this would exceed the maximum lawful rate of interest.

But bankers found a way in circumventing this difficulty. Lloyd LJ in the *Pinios Shipping* case put it thus (at 225, 226):

> But bankers found a way round this difficulty. At the end of six months the parties were presumed to settle their account, without any previous agreement. Instead of the customer paying the amount of interest then due, it was added to the principal. The banker forbore to sue for principal and interest, since he was content to charge interest on the new principal over the next six months.
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> This practice was upheld as lawful by Lord Eldon LC in *Ex p Bevan* [1803] 9 Ves 223 at 224; 32 ER 588.

And by Nicholls LJ in the same case (at 233):

> To facilitate the use of compound interest by banks despite the usury laws, which were not finally repealed until the Usury Laws Repeal Act 1854, the Courts resorted to the fiction that a fresh agreement for the payment of interest was made on the occasion of each rest in a customer's account. An agreement, express or implied, to pay compound interest made when a customer opened an account with a bank would have been unlawful. But, if on each occasion when a bank charged or credited interest to an account the parties were to enter into a new agreement that the balance then struck would bear interest, that agreement would be lawful because it would provide only for the payment of simple interest on an agreed sum. Thus, on this analysis, over a period of years there would be a series of separate agreements between banker and customer, made at intervals of one year or six months or whenever, depending on the manner in which the bank kept its accounts. That notion, of each debiting or crediting of interest being the subject of a separate, fresh agreement, was fundamental to the lawfulness of this practice. There was a succession of agreements, implied from the customer's acquiescence in the practice of the bank regarding the debiting and crediting of interest.

Thus Lord Eldown LC in *Ex p Bevan* [1803] 9 Ves 223 at 224; 32 ER 588 said:

> it is clear, you cannot a *priori* agree to let a man have money for twelve months, settling the balance at the end of six months; and that the interest shall carry interest for the subsequent six months: that is, you cannot contract for more than 5 per cent; agreeing to forbear for six months. But, if you agree to settle accounts at the end of six months, that not being part of the prior contract, and then stipulate, that you will forbear for six months upon those terms, that is legal.

In *Paton v. IRC* [1938] 1 All ER 786 at 795, [1938] AC 341 at 357 Lord Macmillan commented on that principle and its survival despite the repeal of the usury laws:

> On this principle it was held in *Eaton v. Bell* ([1821] 5 B & Ald 34; 106 ER 1106) that the bankers who, with the knowledge of, and without objection by, their customers, debited them with interest with half-yearly rests in accordance with their general practice did not offend against the usury laws. This method of dealing with loan accounts, which became common form among bankers, survived the abolition of the usury laws and is well established as the ordinary usage prevailing between bankers and customers who borrow from them and do not pay the interest as it accrues.

And this is how Lord Goff put it in the same case (but in the House of Lords), at 1336:

> However, in *Ex parte Bevan* [1803] 9 Ves Jun 223, 224 Lord Eldon LC succeeded in circumventing this difficulty by holding that:
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> > if you agree to settle accounts at the end of six months, that not being part of the prior contract, and then stipulate, that you will forbear for six months upon those terms, that is legal.
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> On this basis it came to be held that, if there was 'acquiescence' by a customer in his banker's capitalising interest at annual rests, an agreement could be presumed each year on the basis proposed by Lord Eldon: see *Lord Clancarty v. Latouche* [1810] 1 Ball & B 420, in which Lord Manners LC said, at pp. 429-430:
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> > From the acquiescence of Mr. Connolly I ought to presume an agreement at the end of every year, that the interest then due, should become principal and carry interest, which, according to *Ex parte Bevan*, this Court will admit of, and that was a case of half-yearly rests.

> A similar conclusion was reached in *Eaton v. Bell* [1821] 5 B & Ald 34. This approach, which presupposed what Mr. Pickering rightly described as a series of staccato agreements, was obviously a fiction: Lord Macmillan was later to characterise it as 'an agreeable fiction:' see *Paton v. Inland Revenue Commissioners* [1938] AC 341, 357. Its function was only to circumvent the usury laws; once those laws had been repealed in 1854, there was no sensible basis on which it should have been allowed to survive.

Lord Goff later went on to say, at 1341:

> I wish to return to the basis on which the original case of *Ex parte Bevan,* 9 Ves Jun 223 was decided.
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> In that case, as I have said, it was decided that the usury laws might be circumvented by the fiction of a series of staccato agreements whereby, at each rest, it was presumed to have been agreed that the interest then due could 'become principal and carry interest.' The practical effect was, of course, that bankers did indeed capitalise interest in this way. After the repeal of the usury laws in 1854, they continued, as they had done in the past, to follow what had become a practice of bankers. In *Inland Revenue Commissioners v. Lawrence Graham & Co.* [1937] 2 KB 179, Romer LJ (delivering the judgment of the Court of Appeal) said, at p. 192, that the practice was:
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> > an old one dating back to long before the repeal of the usury laws, and could not, therefore, have been legal unless it was consistent with those laws. Now before the repeal of those laws a contract to allow the charging of compound interest was illegal. The legality of the practice of bankers was, however, upheld by the Courts by treating the bank as making a fresh advance to its customer at the end of each year or half-year as the case might be: see (eg) *Lord Clancarty v. Latouche,* 1 Ball & B 420. There is nothing contrary to the usury laws in such an arrangement: see *Ex parte Bevan,* 9 Ves Jun 223. It is plain that upon the repeal of those laws an agreement to pay compound interest became lawful.

This method of circumventing the usury laws, which had prohibited the charging of compound interest, by capitalising interest in the way described above had survived the abolition of the usury laws in 1854 even though there was no sensible basis on which it should have been allowed to survive.

> Its function was only to circumvent the usury laws; once those laws had been repealed in 1854, there was no sensible basis on which it should have been allowed to survive.

said Lord Goff in the *Pinios Shipping* case, at 1336. Not only did it survive the abolition of the usury laws, it soon became "well established as the ordinary usage prevailing between bankers and customers" as the following passage from *Paton v. IRC* [1938] AC 341 shows. Lord Macmillan said thus (at 357):

> My Lords, the origin of this agreeable fiction whereby debts are to be deemed to be paid without payment may be traced historically to the ingenuity of lenders in devising a method of obtaining compound interest without contravening the usury laws. It was illegal by an antecedent contract to stipulate for the payment of compound interest, 'but if you agree to settle accounts at the end of six months, that not being part of the prior contract, and then stipulate that you will forbear for six months upon those terms [i.e., that the interest shall carry interest for the subsequent six months] that is legal': per Lord Chancellor Eldon in *Ex parte Bevan* 9 Ves 223, 224. On this principle it was held in *Eaton v. Bell* 5 B & Ald 34 that bankers who, with the knowledge of and without objection by their customers, debited them with interest with half-yearly rests in accordance with their general practice, did not offend against the usury laws. This method of dealing with loan accounts, which became common

a form among bankers, survived the abolition of the usury laws and is well established as the ordinary usage prevailing between bankers and customers who borrow from them and do not pay the interest as it accrues.

This practice of bankers soon became implied into the relevant contract between banker and customer. Thus, in *National Bank of Greece v. Pinios Co. No. 1* [1989] 3 WLR 1330, 1331, it was held by the House of Lords that the bank was entitled to capitalise interest as this b was implied by the usage of bankers. See the judgment of Lord Goff (who delivered the main judgment of the Court), at 1341-1343.

Lord Justice-Clerk Inglis in *Reddie v. Williamson* [1863] 1 Macph 228, 236 expressed on this usage of bankers thus:

c The parties must of course have had in view that this account-current would be kept in the way, in which bankers always keep such accounts, balancing the account at the end of the year; and, in the event of the interest accruing during the past year not being otherwise paid or provided for, placing the amount of such interest as the last item to the debit of the account, and accumulating such interest along with the principal sum due on the account, and bringing down the balance thus ascertained consisting partly of principal, and partly of interest, to the new account for the ensuing year, and placing the accumulated balance as the first article of debit in that new account. Where an account is kept in this way consistently throughout its d whole course, the interest thus accumulated with principal, at the end of each year not only becomes principal, but never thereafter ceases to be dealt with as principal.

He then went on to say, at 237:

The privilege of a banker to balance the account at the end of the year, and accumulate the interest with the principal, is founded on this plain ground of equity, that the interest ought e then to be paid, and, because it is not paid, the debtor becomes thenceforth debtor in the amount as a principal sum itself bearing interest.

If the interest is capitalised in this way, i.e., by accumulating interest with the principal and making it a debt in the amount as a principal sum itself bearing interest, this will, in my judgment, attract *ad valorem* duty under s. 28(2) of the Stamp Ordinance 1949 if by so doing it exceeds the amount for which the stamp on the security covers.

f

Section 28 of the Stamp Ordinance reads:

28 (1) A security for the payment or repayment of money to be lent, advanced or paid, or which may become due upon an account current, either with or without money previously due, shall be charged, where the total amount secured or to be ultimately recoverable is in any way limited, with the same duty as a security for the amount so limited.

g (2) Where such total amount is unlimited, the security is to be available for such an amount only as the *ad valorem* duty stamped thereon extends to cover; but where any advance or loan is made in excess of the amount covered by that duty the security shall for the purposes of stamp duty be deemed to be a new and separate instrument bearing date on the day on which the advance or loan is made.

h Section 88 of the United Kingdom Stamp Act 1891 is similar in terms to our s. 28. In *Waterhouse's v. Policy* [1937] 2 All ER 91, Farwell J said, at 95:

Now the whole controversy depends upon two sections of the Stamp Act 1891. Section 88(1) provides:

A security for the payment or repayment of money to be lent, advanced, or paid, or which may become due upon an account current, either with or without money previously i due, is to be charged, where the total amount secured or to be ultimately recoverable is in any way limited, with the same duty as a security for the amount so limited.

So far, there does not appear to be any difficulty. Where the loan is for a definite fixed sum, and any security is given for that sum, then there has to be a stamp duty which is sufficient to cover the total amount to which the borrower is entitled. Then s. 88(2) provides:

> Where such total amount is unlimited, the security is to be available for such an amount only as the *ad valorem* duty impressed thereon extends to cover, but where any advance or loan is made in excess of the amount covered by that duty the security shall for the purpose of stamp duty be deemed to be a new and separate instrument, bearing date on the day on which the advance or loan is made.

And this is what the Judge said in relation to the effect of s. 88(2), at 96, thus:

> Where, as in this case, the bank permits one of its customers to overdraw his account, and there is no limit placed upon the amount of the overdraft, or, if there is a security, the security is to be a security for a limited amount only, and any overdraft allowed beyond that is not covered by that security, then there is no necessity to stamp the security for any amount greater than the amount for which the bank looks to the security as a security for the loan. Thus, if the bank chooses to take a security for an overdraft, and stamps that security with a stamp which is only sufficient to cover a limited sum, say £500, then, as a result of subsection (2), it is precluded from claiming, either in any Court of law or elsewhere, that the security which it has is a security for any greater sum than that for which the stamp on it covers. If a bank or any other person lends money, with no limit on the amount which is lent, and stamps the security which it takes with a limited stamp, and desires that security to be increased so as to cover a larger sum, then, on every occasion when it is desired to increase the security, it is necessary to stamp the security with a further duty, and for that purpose the security shall be deemed to be a new and separate instrument, bearing date on the day on which the loan is made. If no such step is taken, then the lender is precluded from claiming the security, whatever the particular form of the security may be, as security for any amount over that which the stamp on it will cover.

When reading the judgment of Farwell J, it is prudent also to read the note at the end of the report that is found in "*Legal Decisions Affecting Bankers*" Vol. V, 1937-1946, at 29, 30.

Perhaps the following observations by Nicholls LJ in the *Pinios Shipping* case is apt ([1989] 1 All ER 213, at 230):

> We were told by Counsel for the bank that a decision to the above effect would cause dismay and consternation among bankers. If so, the remedy lies in their own hands. They should make express provision for compound interest in their contracts. Since the repeal of the Usury Acts there has been nothing to stop them. Why they have not done so I do not know. But it may be that the explanation is to be found in the mordant observations of Lord Atkin in *Paton v. IRC* [1938] 1 All ER 786 at 795. [1938] AC 341 at 357:
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> > 'It is obvious that the system adopted by banks, which seems to have been common practice in the time of Lord Eldon LC is for the purpose of giving them compound interest without perhaps flouting that fact before the customers'.

And also that of Romer LJ in *Inland Revenue Commissioners v. Lawrence Graham & Co.* [1937] 2 KB 179, 199 which is also appropriate:

> It is plain that upon the repeal of those laws an agreement to pay compound interest became lawful. In *Holder's* case [1932] AC 624, however, there was no agreement to pay it. The bank had merely pursued an old practice of bankers upon which an interpretation had been put by the Courts. The fact that this had been done at a time when the laws against usury were in force appeared to this Court to be immaterial. The practice continued after the repeal of those laws and the repeal could not affect the nature of the practice.

The nature of the practice of bankers is to capitalise interest. It is because that that is the nature of their practice that bankers now find that the type of transactions described above attracts *ad valorem* duty under s. 28(2) of the Stamp Ordinance. Actually the remedy lies in their own hands. They should make express provision for compound interest in their contracts: see s. 14 of the Act. In the absence of such express provision for compound interest, the practice of bankers inevitably must prevail. In the present context, it is the practice that is their undoing.

There is more than one way for bankers to get what they want upon usury; by capitalising the interest or by compounding it. As "all roads lead to Rome", yet they choose the arduous one.

So I would adjourn all these cases *sine die* until the security which the chargee plaintiff is relying on has been upstamped with the correct amount of *ad valorem* duty.

Bankers throughout the countries of the Commonwealth have stubbornly continued to cling to the practice of bankers to capitalise interest when they could so easily have included in their contracts a provision for compound interest. Perhaps bankers still keep in their breasts a misguided belief that there is some sort of a tax or other advantage which is available to them when they capitalise interest. But, as the following cases would show, they have yet to succeed.

In re Morris [1922] 1 Ch 126 is a case where there was an express provision for compound interest. Nevertheless it was argued on behalf of the mortgagee that the interest had been capitalised. But this argument did not move the English Court of Appeal which decided that the compound interest had not been capitalised and that it (compound interest) was "interest of money" within the meaning of the Income Tax Act 1918 and therefore subject to income tax.

This is what the headnote reads:

> By deed dated 6 June 1898, some of the then next of kin of a lunatic for valuable consideration conveyed by way of mortgage their expectancies in the estate of the lunatic to an insurance society subject to redemption on payment to the society of £40,000 at any time after the death of the lunatic with compound interest thereon at the rate of 4½ per cent per annum with annual rests.
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> On the death of the lunatic her estate was administered by the Court and by the order on further consideration the £40,000 was paid to the society out of funds in Court and sufficient funds were carried over to a separate account to answer the compound interest payable under the deed subject to income tax (if any). The society claimed payment of the compound interest without deduction of income tax on the ground that it had been capitalised:
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> Held, that the compound interest had not been capitalised, and was 'interest of money' within r. 1(a) of case III in Sch D to the Income Tax Act 1918 and that the mortgagors under r. 19(1) of the General Rules applicable to all the schedules to the Act were entitled on payment of the interest by way of deduction for income tax to so much of the funds carried over to the separate account as was equal to the income tax in each yearly instalment of interest as and when it became due.

In *Paton v. IRC* [1938] AC 341, the headnote reads:

> Section 36, subsection of the Income Tax Act 1918, provides that 'Where interest payable in the United Kingdom on an advance from a bank carrying on a *bona fide* banking business in the United Kingdom is paid to the bank without deduction of tax out of profits or gains brought into charge to tax, the person by whom the interest is paid shall be entitled on proof of the facts to the satisfaction of the Special Commissioners, to repayment of tax on the amount of the interest.'

> In 1918 F borrowed from a bank £250,000 on the security of certain property. At the material date F had paid nothing on the account in reduction of principal or interest, the bank debiting the account each half-year with the interest thereon, and carrying forward the accumulated amount:
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> Held, that the action of the bank in so debiting the account with interest did not constitute as between it and F a payment of interest by F within the meaning of s. 36, subsection (1), of the Income Tax Act 1918, so as to entitle the trustee of F's estate to recover the amount of income tax thereon.

The appellant Paton (the surviving trustee of two deeds of arrangement executed by Fenton) had contended that in view of the bank's practice of adding the interest of each half-year to the amount advanced (i.e., capitalising the interest) the interest in question had in fact and in law been paid each half-year: see at 343. But Sir Donald Somervell A-G for the crown had contended thus (at 345):

> The authorities are inconsistent with the notion that interest is paid by means of a fresh advance: *Ex parte Bevan* [1803] 9 Ves 223; *Eaton v. Bell* [1821] 5 B. & Ald. 34. As was said by Lord Justice-Clerk Inglis in *Reddie v. Williamson* [1863] 1 Macph 228, 236: 'where an account [in the bank's books] is kept in this way consistently throughout its whole course, the interest thus accumulated with principal, at the end of each year not only becomes principal, but never thereafter ceases to be dealt with as principal.': see also *Inland Revenue Commissioners v. Holder* [1931] 2 KB 81, 94. In *re Jauncey, Bird v. Arnold* [1926] Ch 471, 476; Russell J in dealing with a contention that where in a mortgage deed containing a provision that, whenever interest was in arrears for twenty-one days, it should be treated as an accretion to the capital moneys and should thenceforth bear interest, interest must be deemed to have been paid, said that 'the interest is not capitalised because it is in fact paid, but because it has in fact not been paid.' That decision clearly negatives the contention of the present appellant.

And the House of Lords agreed with him.

Capitalisation of interest does not mean that interest has in fact been paid. It means that interest has in fact not been paid. It is because that the interest was not paid that it is to be capitalised (as this is the practice of bankers) in the sense that the interest is converted into capital.

In *IRC v. Oswald* [1945] AC 360, Lord Thankerton said, at 367:

> The main question is whether by virtue of the two instruments dated 9 August 1935, and 13 September 1938, whereby the mortgagee's trustees exercised the option conferred by the indenture of further charge dated 18 May 1905, the unpaid interest so capitalised was paid within the meaning of r. 21 of the General Rules applicable to all schedules, the material part of which provides as follows, (1) Upon payment of any interest of money, annuity or other annual payment charged with tax under Sch D, or of any royalty or other sum paid in respect of the user of a patent, not payable, or not wholly payable out of profits or gains brought into charge, the person by or through whom any such payment is made shall deduct thereout a sum representing the amount of the tax thereon at the rate of tax in force at the time of the payment.'

This is how he concluded, at 369, 370:

> I am of opinion that this case falls within the principle of the decision of this house in *Paton v. Inland Revenue Commissioners* [1938] AC 341 in which it was held that the practice of banks to add interest to principal by half-yearly rests did not constitute as between the bank and its customer a payment of interest by the customer within the meaning of s. 36, subsection (1), of the Act of 1918, so as to entitle the trustee of the customer's estate to

recover the amount of income tax thereon. As my noble and learned friend Lord Macmillan states, at 356: 'It is a condition of a claim for repayment of tax on bank interest under s. 36, subsection (1), that the taxpayer shall have 'paid' to his bank the interest in respect of which he claims repayment of tax. In my opinion this means that the taxpayer must really, and not merely notionally, have paid the interest; there must be payment such as to discharge the debt; the payment must be a fact not a fiction.'

And he said, at 371:

> Accordingly, I am of opinion that there was no payment of interest within the meaning of r. 21, by virtue of the two instruments dated respectively 9 August 1935, and 13 September 1938, executed by the mortgagee's trustee.

In the Australian case of *Bank of New South Wales v. Brown* [1982-1983] 151 CLR 514, s. 112 of the Bankruptcy Act 1966 (Commonwealth) provides that where the creditor has proved a debt for or includes interest, the interest, for the purposes of dividend, is to be allowed at a rate not exceeding 8% per annum. I read from the headnote:

> A company's account with its banker was in overdraft. The bank charged interest on the daily balance of the account with six monthly rests. At the expiration of each six monthly period the accrued interest was debited to the account in accordance with the bank's usual practice, which was accepted by the company. At each six monthly rest interest was charged not only on the previous principal sum but also on accrued interest debited to the account. The rate of interest exceeded 8 per cent per annum. The company went into liquidation. In support of a proof of debt lodged with the liquidator, the bank claimed that when the accrued interest was debited to the account it lost its quality of interest and was converted into capital and that accordingly s. 112 did not apply.

It was held by the High Court of Australia that for the purposes of s. 112, the accrued interest so debited should be treated as interest. Gibbs CJ said at 523:

> There is no legal principle that requires a Court, in applying s. 112 of the Bankruptcy Act, to treat a payment which in truth included interest as though it did not. Section 112 is obviously enacted for the benefit of the creditors generally. A banker and a customer cannot, by agreement among themselves, affect the statutory priority which s. 112 affords.

I must express my gratitude to Mr. MS Murthi who has given so much of his time and assistance to this Court as *amicus curiae*. I am also indebted to all Counsel for their industry and research in these matters. I wish to make particular mention of Mr. JC Leong and Mr. MS Murthi as by their efforts they have provided me with material for this judgment.

Also found at [1991] 1 CLJ 718